

Office of Chief Counsel  
Internal Revenue Service

**memorandum**

CC: [REDACTED] TL-N-1489-99

date: MAY 05 1999

to: [REDACTED], Revenue Agent

[REDACTED], Excise Tax Specialist

from: Karen Sommers, Attorney  
San Diego Associate District Counsel Office

---

subject: [REDACTED]

Response to Taxpayer's excise tax refund claims

DISCLOSURE LIMITATIONS

*This advice constitutes return information subject to I.R.C. § 6103. This advice contains confidential information subject to the attorney-client and deliberative process privileges and, if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the recipient of this document may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to persons beyond those specifically indicated in this statement or to taxpayers or their representatives.*

*This advice is not binding on the Internal Revenue Service and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgment of the office with jurisdiction over the case.*

11207

ISSUES

1. Whether the taxpayer's various refund claims with respect to the I.R.C. § 4371(3) excise tax on premiums paid to a foreign reinsurer were presented to the Service within the applicable period of limitations.

2. District Counsel's assistance was requested in evaluating the amended excise tax refund claims set forth in the taxpayer's January 9, [REDACTED], letter to Examination, with respect to the following:

a. Is there a legal basis for the taxpayer's "Position C" (reducing premiums by ceding commissions) or "Position D" (reducing premiums by ceding commissions, loss adjustment expenses, and losses paid) to arrive at premiums subject to the § 4371(3) excise tax?

b. Are the Funds Withheld shown by the taxpayer on the NAIC reports to the State of California cumulative, and does all or a portion of the Funds Withheld account correspond to the "annual positive reserve adjustment" item referred to in PLR 9302011?

c. What issues may be present with respect to the \$ [REDACTED] "return premium on termination" which the taxpayer claims was returned from [REDACTED] to the taxpayer on termination of [REDACTED] contracts?

FACTS

[REDACTED] (hereinafter [REDACTED]) is a [REDACTED] insurance company with an emphasis in [REDACTED] insurance. [REDACTED] was [REDACTED] by the State Insurance Commissioner on [REDACTED] pursuant to a court order filed on the same date. This order was granted pursuant to [REDACTED] law, based upon a finding that the further transaction of business would be hazardous to its policyholders, creditors and the public. The [REDACTED] was not premised on any determination that [REDACTED] was insolvent.

[REDACTED] reinsured a portion of its risks with three foreign insurance companies. The Service, pursuant to I.R.C. § 4371(3), made the following assessment in June, [REDACTED]:

<u>Reinsurer</u>	<u>Tax Period</u>	<u>Excise Tax Determined</u>	<u>Reported (Form 720)<sup>1</sup></u>	<u>Excise Tax Assessed</u>
[REDACTED]	[REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED] <sup>2</sup>
	[REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]
	[REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]
	[REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]
[REDACTED]	[REDACTED]	\$ [REDACTED]	[REDACTED]	\$ [REDACTED]
	[REDACTED]	\$ [REDACTED]	[REDACTED]	\$ [REDACTED]
	[REDACTED]	\$ [REDACTED]	[REDACTED]	\$ [REDACTED]
[REDACTED]	[REDACTED]	\$ [REDACTED]	[REDACTED]	\$ [REDACTED]
	[REDACTED]	\$ [REDACTED]	[REDACTED]	\$ [REDACTED]

TOTAL ASSESSED:

\$ [REDACTED]

The above assessments represent [REDACTED] % of the ceded reinsurance premium amounts reported on Schedule F of [REDACTED]'s Annual Statement filed with the State Insurance Department for [REDACTED] through [REDACTED]. The outstanding liability based upon the excise tax assessments was satisfied via the transfer of overpayments from the taxpayer's [REDACTED] income tax account (in July, [REDACTED]) plus overpayments from the [REDACTED] income tax account (in January, [REDACTED]). However, these credit transfers on the transcripts of account bear dates of [REDACTED] and [REDACTED], respectively, which correspond to the dates the payments were credited to the income tax accounts.

The taxpayer ([REDACTED]) has filed refund claims which dispute the merits of the excise tax liabilities. The excise tax specialist has prepared a chart of all claims filed and the tax payments to which they relate, attached to her memorandum dated [REDACTED]. The taxpayer

<sup>1</sup> The Forms 720 do not specify the reinsurance company on behalf of which the excise tax is paid; however, the Form 5471 for [REDACTED] reports a deduction for excise taxes and the taxpayer agrees that no excise taxes were paid on behalf of either [REDACTED] or [REDACTED]. Thus, the agent has applied the insurance excise tax payments to [REDACTED].

<sup>2</sup> Because the normal period of limitations expired for the first through third quarters of [REDACTED], an assessment was made only for the fourth quarter of [REDACTED]. The amount assessed was determined by taking one-fourth of the liability determined for the entire [REDACTED] taxable year (i.e. 25% of (\$ [REDACTED] minus \$ [REDACTED])).

submitted a letter to the Service dated [REDACTED], which raises additional claims.

### DISCUSSION

#### **I. Timeliness of claims**

Generally, a claim for refund must be filed within three years from the time the return was filed or within two years from the time the tax was paid, whichever is later. I.R.C. § 6511(a).

The excise tax specialist provided a claims schedule showing that the taxpayer filed its initial refund claims on June 8, [REDACTED] with respect to the Forms 720 for [REDACTED] through [REDACTED] and [REDACTED] through [REDACTED]. Claims were filed on April 30, [REDACTED] for the four quarters of [REDACTED]. She then pointed out that with respect to the Forms 720 for March [REDACTED] through September [REDACTED], the refund claims were filed more than two years after April 15, [REDACTED] payment date shown on the transcripts and more than three years after the filing of the returns. Counsel's opinion on this apparent late claim was requested.

Section 7422(d) of the Code provides that any overpayment transferred as a credit to satisfy any tax liability shall be treated as a payment in respect of such liability at the time such credit is allowed. Therefore, the "payment dates" for purposes of ascertaining the timeliness of any refund claim is the date the income tax overpayment credits were actually transferred to satisfy the excise tax liabilities.

The transcripts show the "original" date the credits arose, presumably for purposes of calculating any interest due on the accounts. While the transcripts do not show the exact date of the overpayment credit transfers, it is clear from their chronological position on each transcript, following the entry of the [REDACTED] assessments, that the transfers took place shortly thereafter. (Our files also contain copies of notices to the taxpayer, announcing that these credit transfers took place, dated in July, [REDACTED].) Therefore, as to all the payments from that date forward, the refund claims in this case are timely because they were made within two years from the date of payment. Cf. Kingston Products Corp. v. United States, 368 F.2d 281, 287 (Ct. Cl. 1966).

Where an agreement is entered to extend the period for assessment (generally by form 872), the time for filing a claim does not expire until six months after the expiration of the assessment period as extended. I.R.C. § 6511(c)(1). The amount which may be claimed when an extension is present is equal to the

tax paid after the execution of the extension, plus any amounts that could have been claimed on the date the extension was executed. I.R.C. § 6511(c)(2).

Forms 872 extending the period of limitations on assessment to December 31, [REDACTED], were executed by the taxpayer and the Service for the periods [REDACTED] through [REDACTED]. (We assume for the purposes of this discussion that these forms were executed before the normal 3-year under § 6501(a) period of limitations on assessment.) Therefore, with respect to all of the amounts paid toward these accounts, including payments with the original returns, the time for filing a claim for refund did not expire until June 30, [REDACTED] (six months after December 31, [REDACTED]). I.R.C. § 6511(c)(2).

The transcript of account for the quarter ending December, [REDACTED], indicates that there was a Form 872 extending the assessment period of limitations until December 31, [REDACTED], so any claim filed before June 30, [REDACTED], is timely with respect to all payments on that period.

Finally, it appears that the January, [REDACTED], request from the taxpayer to the Service claims larger refunds for all periods: namely, the entire amount of tax paid, including the tax paid with the original returns. The April and June [REDACTED] claims were for the amount of the [REDACTED] additional assessments and payments thereof. If the Service were to raise this issue as a jurisdictional bar to an eventual refund suit by the taxpayer, we believe that these claims would likely be treated as amendments to the original timely claims.

An amendment to an existing claim, raising a new ground, is not permitted after the statute of limitations has expired. Favell v. United States, 19 Ct. Cl. 521 (1990); Union Pacific Railroad Co. v. United States, 389 F.2d 437 (Ct. Cl. 1968). However, if the facts upon which the amendment is based would necessarily have been ascertained in determining the merits of the original claim, an amendment is considered to relate back to the date of the original claim. Mutual Assurance, Inc., v. United States, 56 F.3d 1353 (11<sup>th</sup> Cir. 1995).

It appears in this case that the ground upon which the excise tax refunds are sought in the January [REDACTED] amendment is simply a continuation of the taxpayer's original claim based on its theory that only net amounts transferred to the reinsurance companies can be treated as premiums for purposes of the § 4371(3) tax. Further supporting the "amended claim" approach is the considerable discussion that has occurred between the taxpayer and the Service concerning the impact of the termination of the [REDACTED] contracts, and the "repayment" by [REDACTED] to [REDACTED] of some \$ [REDACTED], on the issue of the calculation of

return premiums. Thus, the Service would not be able to demonstrate that it was surprised by a new claim on different grounds from the original.

#### II.a. Taxpayer's "Position C" and "Position D"

The Service's position with respect to the taxpayer's subtraction of ceding commissions from premiums paid ("Position C") has been addressed in our request for field service advice still pending in the National Office. (We have been informed that a response should arrive with the next few weeks.) As set forth in this office's field service advice request memorandum, the Service's position is that ceding commissions may not reduce premiums paid for purposes of the § 4371(3) excise tax. The taxpayer's more aggressive position ("Position D") which subtracts losses paid and loss adjustment expenses, in addition to ceding commissions, is likewise wholly contrary to the Service's position on the meaning of "premium paid" under § 4371(3).

#### II.b. Meaning of "Funds Withheld"

With respect to the question on whether the Funds Withheld amount reported on the NAIC report filed with the State of California is a cumulative amount, the answer appears to be affirmative. This can be confirmed by comparing the NAIC amounts to the amounts reported on [REDACTED]'s statement for Line 19 (Other current liabilities) attached to its Form 1120-PC. Consequently, the State of California amounts may not necessarily reconcile with the amounts reported on the taxpayer's claim since the actual amount of the funds withheld may increase or decrease throughout the year as monies are deposited and/or withdrawn.

It is essential to determine whether the "funds withheld" amounts used in the refund claims represents the cumulative balance at the end of each quarter for each reinsurance company or whether it represents the "funds withheld" amount attributable to the additional premiums paid for that quarter. Based on the large amounts reported--which, by the way, has no apparent proportional relationship to the amount of the premiums paid--it appears that the taxpayer is using a cumulative balance (i.e. the balance of the funds withheld account at the end of each quarter for each reinsurance company). If this is the case, it is clearly inappropriate. The computation of the excise tax in this case was based on the amount of the additional premiums paid for each period, not the cumulative amount paid at the end of each period. Consequently, to compare apples with apples, the taxpayer should be subtracting only the portion of the funds withheld balance that is attributable to the additional premiums

paid for each quarter, which should considerably reduce the amount of their claims.

It is unclear whether any part of the "funds withheld" category in this case corresponds to the "annual positive reserve adjustment" described in PLR 9302011. In the letter ruling, that term was specifically described in the reinsurance contract at issue, and was determined to be a category of "return premium" which reduces premiums paid for excise tax purposes. Regardless of terminology, it would appear that to the extent any termination payments from [REDACTED] to [REDACTED] represent premiums for policies which were in force at the time the reinsurance contracts with [REDACTED] were canceled, the taxpayer would be entitled to treat such amounts as return premiums for excise tax purposes.

As the excise tax specialist's memorandum points out, however, it is highly suspect that for roughly a [REDACTED] dollars in cede insurance over nearly [REDACTED] years, \$[REDACTED] is alleged to have been "return premiums" in the final analysis.

#### II.C. [REDACTED] termination payments

The taxpayer's claims refer to "payment" of over \$[REDACTED] in return premiums from [REDACTED] upon termination of the reinsurance contracts in [REDACTED]. We agree the this issue requires additional development. The agreement with respect to the termination of the [REDACTED] reinsurance contracts between [REDACTED], [REDACTED], the Insurance Commissioner, and [REDACTED] and [REDACTED] ([REDACTED] and [REDACTED]) make it clear that nearly \$[REDACTED] of this amount consists of unsecured promissory notes from the [REDACTED] to [REDACTED], which notes now been assigned by [REDACTED] to [REDACTED]. The settlement agreement appears to provide that a substantial portion of this amount is contingent upon [REDACTED] (via its liquidating trust) being unable to pay claims. All projections thus far in this case is that that is an extremely unlikely scenario. If [REDACTED] remains solvent, then the settlement between [REDACTED], [REDACTED], and the [REDACTED] provides that [REDACTED]'s trustees may demand payment, but not before May, [REDACTED]. Thus, the amount may not be fixed and ascertainable in [REDACTED], and could not be taken into account in that year or earlier years for purposes of determining "return premiums" reducing excise tax payable. It will be useful to ascertain the taxpayer's position on this issue

If you have any questions, please contact me at 557-6014.

---

KAREN NICHOLSON SOMMERS  
Attorney